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UNCLAS SECTION 01 OF 02 KUALA LUMPUR 000380

SENSITIVE

SIPDIS

STATE PASS USTR -- WEISEL AND BELL

STATE PASS FEDERAL RESERVE AND EXIMBANK

STATE PASS FEDERAL RESERVE SAN FRANCISCO TCURRAN

SINGAPORE PASS TO SBAKER

USDOC FOR 4430/MAC/EAP/M.HOGGE

TREASURY FOR USTR

E.O. 12958: N/A

TAGS: [EFIN](#) [ECON](#) [IEINV](#) [ETRD](#) [PREL](#) [PGOV](#) [MY](#)

SUBJECT: MALAYSIA: ECONOMIC PROSPECTS AND FINANCIAL SECTOR

REFORMS

REF: A. KUALA LUMPUR 195

[1B.](#) KUALA LUMPUR 318

[1C.](#) BEIJING 1267

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[11.](#) (U) Summary and comment: Central Bank Deputy Governor Ooi Sang Kuang reports that Malaysia is seeing signs of a U-shaped recovery with positive growth in the fourth quarter of 2009. Ooi credits GOM monetary and fiscal policy (Ref A) as well as financial sector liberalizations (Ref B) for the brighter prospects. New licenses for foreign banks promised as part of the financial sector liberalization plan announced by the PM April 27 (reftel) will be granted to those banks that can fill a "gap" in the Malaysian financial sector and "increase linkages" with other economies. Beginning in 2010, banks with offshore operations will be permitted to apply for onshore operations in Malaysia, subject to criteria that are still being developed.

[12.](#) (SBU) Comment: While the GOM has made clear that the new banking licenses will be a matter of negotiation, the fact that Malaysia is opening up to foreign banking after being closed for decades is a significant step forward. Looking ahead, the Central Bank is developing its new ten-year "Financial Sector Master Plan" which likely will involve slow but steady liberalization of the tightly-controlled sector. End summary and comment.

RECESSION AND RECOVERY: VIKING SHIP OR U-SHAPE?

[13.](#) (U) On May 12, Econcouns met with Central Bank Deputy Governor Ooi Sang Kuang to discuss the state of the Malaysian economy and the recent financial sector liberalization package. Ooi expressed optimism that Asian economies were springing "green shoots" of new life, citing Malaysia's positive month-on-month export figures as evidence. While year-on-year exports remained down, Ooi hopes the external sector has hit bottom this month. "China has turned around," Ooi said, pointing to improved month-on-month trade figures

for Taiwan, Korea, and mainland China to underline his hope that demand in China would pull the rest of Asia out of recession. (Note: China posted positive month-on-month export figures for April, although year-on-year figures remain down (Ref C). End note.)

CONTRIBUTORS TO RECOVERY: MONETARY AND FISCAL POLICY

14. (U) Ooi was optimistic that Malaysia would see a turnaround by the fourth quarter. He expected growth in the first quarter to be negative, the second quarter to remain negative but less so, with "stabilization" in the third quarter and positive growth in the fourth. Malaysia's "front-loaded" monetary policy with early, successive interest rate cuts was effective, he explained. He credited the government's fiscal stimulus package for sustaining domestic demand; forecasting that most of the spending would "hit the ground" in the third quarter. Ooi also observed that lower- and middle-income groups in Malaysia seemed to be spending as usual. "Malls are still seeing heavy traffic," he said, explaining that "only the very high end" of the income ladder was affected significantly by the economic crisis. Electronics manufacturing, the mainstay of Malaysia's export market, had already seen the bottom, he explained. While December and January had seen a dropoff in production, suppliers had been shrinking their inventories and now orders were coming back. "Instead of the Viking-ship shaped recession we had feared, we might have a U-shaped recovery."

LONG-TERM GROWTH WOULD DEPEND ON LIBERALIZATION

15. (U) Ooi explained that the third strategy to prod economic

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recovery) liberalizations in the services sector -- would be the longer-term measures needed to help Malaysia move from a middle-income, manufacturing-based economy to a higher-income, knowledge-based one. The financial sector liberalization announced on April 27 is aimed at "filling gaps" in Malaysia's bid to become a global financial center and a fully developed country. The Islamic banking licenses to be handed out would be for international business; they would not compete with the domestic Islamic banking sector. Likewise, the conventional banking licenses would be targeted to fill "gaps" such as agro-financing or microfinance. A number of foreign banks were lining up to apply for licenses.

"Whatever they can put on the table will make them more competitive," Ooi stated. He further explained that the liberalization would allow foreign banks to open up to ten "microfinance" branches from which business loan amounts would be capped at RM 50,000 (USD 14,000). He pointed to Indonesia and Bangladesh as sources of "very profitable" microfinance operations.

16. (U) Ooi noted that the GOM wanted Malaysian banks to expand throughout the region to assist Malaysian companies also expanding abroad. He pointed out that some Malaysian companies had secured contracts for major infrastructure projects in India, but there were no Malaysian banks there. Separately Nazir Razak, brother of Prime Minister Najib Razak and CEO of Malaysia's CIMB Bank Group, told the press, "We hope to take advantage of some reciprocity as we go abroad."

17. (U) Central Bank Governor Zeti Akhtar Aziz also told the press that the entry of the new players would "be dependent on the value propositions" they bring to the Malaysian system, "to bring world-class products and services to enhance our linkages and so on." On May 13 Zeti told Econoff that new rules allowing offshore banks to apply for onshore licenses would be subject to similar "criteria"; while it "would be premature to comment on what those criteria will be," she explained, "the main point is that it would not be automatic." Onshore licensing would "depend on the bank's

business plan," namely, what the onshore operation would contribute to the development of Malaysia's economy, especially its financial sector.

LOOKING AHEAD

18. (U) Malaysia's central bank is developing a new Financial Sector Master Plan to follow the current ten-year plan scheduled to end in 2010. Although Ooi did not share details, he explained that the main thrust will be to facilitate Malaysian transformation from a manufacturing-based to a services-based economy. Lending would be different, he said; for example, assessing the viability of a services start-up was more complex than that of bricks and mortar. Malaysia's educational system also would need to be improved to meet the needs of a knowledge-based society. As a start, banks and insurance companies no longer had limits on the number of expatriates they could employ. While the GOM encourages the hiring of locals, especially ethnic Malays, it would take time for enough Malaysian professionals to meet the current needs of companies.

KEITH